

**REPORT OF THE AUDITOR-GENERAL TO THE LIMPOPO PROVINCIAL
LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS
OF MAKHADO MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Makhado Municipality which comprise the statement of financial position as at 30 June 2008, statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and Division of Revenue Act, 2007 (Act No. 1 of 2007 (DoRA). This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance on whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.
6. An audit also includes evaluating the:
 - appropriateness of accounting policies used
 - reasonableness of accounting estimates made by management
 - overall presentation of the financial statements.

7. Paragraph 11 *et seq.* of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by the Makhado Municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.
8. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis of accounting

9. The municipality's policy is to prepare financial statements on the basis of accounting determined by the National Treasury, as set out in accounting policy note 1.

Basis for qualified opinion

Corresponding figures

10. In my previous audit report dated 10 June 2008 I was unable to express an audit opinion on the financial statements of the municipality for the year ended 30 June 2007. The qualification matters have not been resolved while no alternative procedures were possible and my audit report is modified regarding the corresponding figures as discussed hereunder.

Unauthorised expenditure

11. The prior year actual expenditure of R272.3 million exceeded the adjusted budgeted expenditure of R251.6 million by R20.7 million. I regard the overspending of R20.7 million as unauthorised expenditure in terms of the definition provided in section 1(1) of the MFMA. This unauthorised expenditure was not previously disclosed nor was it brought into consideration when the current year's financial statements were compiled as required by section 125(2)(d) of the MFMA.

Property, plant and equipment

12. I was unable to confirm or verify by alternative means the existence, completeness, valuation and rights and obligations of property, plant and equipment of R743,6 million recorded in the financial statements due to:
 - With reference to paragraph 9 of this report, the municipality changed their basis of accounting during the year under review which necessitated the unbundling of assets and the restatement of the corresponding figures in the prior year. Although assets were re-valued to their fair values, I was not provided with documentation to support the determination of the values and the process followed.
 - The asset register is not maintained in a logical format to facilitate the verification and identification of the assets of the municipality.
 - Due to inconsistencies between the valuation roll and the asset register of the municipality, land registered in the name of the municipality at R25 million could not be confirmed as being correctly valued in the financial statements.

Revenue and receivables

13. Supporting documentation for receipts and receivables were not submitted. There is also an unreconciled and unexplained difference of R22,6 million between the debtors age analysis and the accounts receivable of R68 million as disclosed in note 10 to the financial statements. Consequently I was unable to confirm the occurrence, cut-off, completeness and accuracy of revenue of R148,9 million and the existence, completeness, valuation, allocation and rights to receivables of R68 million.
14. Property rates totalled R9,2 million for the period under review. A reconciliation between the rates base used in the billing system for property rates, and the rates base used in the valuation roll was not performed. I could not be provided with sufficient evidence to satisfy myself regarding the completeness and occurrence of property rates.
15. According to paragraph 1.12.1 of the accounting policies, service charges are based on consumption metered and an estimate of consumption between the latest meter reading and the reporting date. Services income as disclosed in the statement of financial performance of R112,1 million is, however, only based on metered consumption. No estimate between the latest metered date and 30 June 2008 had been made resulting in the understatement of receivables within the financial statements. The records of the municipality did not allow me to calculate the understatement.
16. The municipality did not reconcile the accounting records to the electricity cash power system. I was not able to perform an alternative procedure to determine the completeness of pre-paid electricity of R9,77 million as a report could not be generated from the cash power system.
17. With reference to note 16.1 to the financial statements and the amount of R5,1 million disclosed as the subsidy for the provision of free basic services to indigent community members, sufficient supporting documentation was not provided to ascertain the completeness and classification of the information presented.
18. The classification of income sources disclosed as service income in note 15 to the financial statements is inaccurate compared to the supporting records of the municipality. As a result the revenue allocation of electricity is overstated by an amount of R5,16 million and correspondingly the revenue allocation of water, sewerage and refuse is understated by R2 million, R2 million and R1 million respectively.
19. The municipality did not adequately provide for the provision of bad debts as required by International Accounting Standard (IAS) 39. Based on the current payment history, the provision is inadequate and accounts receivable is overstated by R21,47 million.
20. Supporting documentation for components of other debtors disclosed in note 11 to the financial statements which totalled R3,795 million could not be submitted. I was unable to confirm the existence, rights to, valuation and allocation of other debtors. The records of the municipality did not permit me to perform any alternative procedures.

Purchases and payables

21. Included in the trade and other payables balance of R26 million are other creditors of R11,817 million. Supporting documentation could not be provided to verify the existence, obligations, valuation and allocation of the other creditors of R11,817 million.

22. There is an unreconciled and unexplained difference of R2,159 million between the Value Added Tax (VAT) returns and the VAT creditor balance of R2,8 million. I was unable to confirm the completeness, valuation, allocation and rights to or obligations in respect of the VAT balance of R2,8 million.
23. Current liabilities within the statement of financial position had been understated by an amount of R1,79 million which consists of retention creditors of R1,2 that were not recorded, and an under-provision for staff leave of R583,713. General expenditure is understated by the same amount.
24. Bulk purchases as disclosed in note 20 to the financial statements have been understated by an amount of R4,978 million as an unexplained difference existed between the disclosed amount and the accounting records of the municipality. I was unable to perform alternative procedures to determine the allocation and classification of bulk purchases amounting to R46,638 million as disclosed in note 20 to the financial statements.

Irregular expenditure

25. The municipality has omitted to disclose irregular expenditure of R378,516, which was incurred during the financial year. This is contrary to section 125(2)(d) of the MFMA, which requires disclosure of irregular expenditure in the annual financial statements.

Cash and bank

26. The bank reconciliation statement does not reconcile to the bank balance per the general ledger. The bank overdraft disclosed in the financial statements was overstated by R5,57 million.
27. The bank reconciliation includes unrecorded items of R13,899 million. As a consequence, I was unable to satisfy myself as to the valuation, allocation and completeness of the bank balance of R7,896 million disclosed in the annual financial statements.

Accumulated surplus

28. The accumulated surplus balance was adjusted by R8,17 million in the current financial years' accounting records. Supporting documentation for the adjustment was not provided. Furthermore, the corresponding figures in the statement of financial performance have not been restated as required by the Statement of Generally Recognised Accounting Practice (GRAP) 3.49. Consequently, I was unable to satisfy myself as to the completeness, existence, valuation and rights to the accumulated surplus balance of R549,7 million.

Grants and subsidies

29. The statement of changes in net assets is incorrect as transfers of R15,6 million from reserves were incorrectly set off to the accumulated surplus. As a result depreciation and the current year surplus is understated by R29,2 million and the depreciation offset is understated by R44,878 million.
30. Assets of R25,26 million, purchased with grants have not been transferred to grant reserves. As a result grants and reserves are understated and accumulated surplus is overstated by R25,26 million.
31. Transfers of R15,6 million do not agree to the amounts in the fixed asset register. As a result grants and reserves are understated by R808,401.

32. Assets financed from grants and reserves amounting to R225,757 million do not reconcile to the amounts disclosed as grants and reserves in the financial statements. As a result grants and reserves are understated by R37,878 million.

Inventory

33. I observed the count of physical inventories on 25, 26 and 27 June 2008. The amount disclosed within the financial statements differs from the period-end variance report by R369,644. As a result, inventories are overstated and expenditure is understated by R369,644.

Capital Commitments

34. Property, plant and equipment under construction of R17,38 million as per Appendix D to the financial statements, is incorrectly disclosed as capital commitments in note 27 to the financial statements. The records of the municipality did not permit alternative procedures to determine the correct value of the commitments to be disclosed in the annual financial statements.

Cash flow statement

35. Information on the cash flow statement that includes cash receipts from ratepayers, government and other; cash paid to suppliers and employees and non-cash adjustments as per Note 22 of R286,9 million; R249,948 million and R6,39 million respectively, cannot be linked to other information to ascertain the classification and accuracy of the information presented.

MFMA disclosure

36. With reference to note 26.5 to the financial statements, no amounts are disclosed as councillor's consumer accounts in arrears as required by section 124(1)(b) of the MFMA. The accounting records of the municipality did not permit me to quantify the value that should be disclosed in the annual financial statements.

Adverse opinion

37. In my opinion, because of the significance of the matters described in the Basis for adverse opinion paragraphs, the financial statements do not present fairly, in all material respects, the financial position of the Makhado Municipality as at 30 June 2008 and its financial performance and cash flows for the year then ended, in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1.

Emphasis of matter

I draw attention to the following further matter:

Amendments to the applicable basis of accounting

38. As set out in accounting policy note 1.1 the National Treasury approved a deviation from the basis of accounting applicable to the municipality in terms of *General Notice 552 of 2007* issued in *Government Gazette 30013 of 29 June 2007*.

OTHER MATTERS

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Non-compliance with applicable legislation

Local Government: Municipal Structures Act, 1998 (Act No. 117 of 1998) (Structures Act)

39. Section 84(1) of the Structures Act regulates the functions and powers of a district municipality which includes the provision of potable water supply systems as well as systems for domestic waste-water and sewage disposal. Despite the fact that the Vhembe District Municipality is the water service authority and Makhado Municipality is the water service provider, the municipality accounted for all water and sewerage related transactions in its accounting records.

Internal controls

40. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the inefficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Unauthorised expenditure			✓		✓
Property, plant and equipment	✓	✓	✓		✓
Revenue and receivables	✓	✓	✓		✓
Purchases and payables	✓		✓		✓
Cash and bank	✓		✓		✓
Grants, reserves and surplus			✓	✓	✓
Inventory	✓		✓		✓
Capital commitments			✓		
Cash flow statement			✓		
MFMA disclosure			✓		

Control environment: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.

Risk assessment: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.

Control activities: policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.

Information and communication: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allows people to carry out their financial reporting duties.

Monitoring: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.

Matters of governance

41. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

Matter of governance	Yes	No
Audit committee		
• The municipality had an audit committee in operation throughout the financial year.		✓
• The audit committee operates in accordance with approved, written terms of reference.		✓
• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		✓
Internal audit		
• The municipality had an internal audit function in operation throughout the financial year.	✓	
• The internal audit function operates in terms of an approved internal audit plan.	✓	
• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		✓
Other matters of governance		
• The annual financial statements were submitted for audit as per the legislated deadlines (section 126 of the MFMA for municipalities and municipal entities).	✓	
• The annual report was submitted to the auditor for consideration prior to the date of the auditor's report		✓
• The financial statements submitted for audit were not subject to any material amendments resulting from the audit.		✓
• No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.		✓
• The prior year's external audit recommendations have been substantially implemented.		✓
Implementation of Standards of Generally Recognised Accounting Practice (GRAP)		
• The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 30 October 2007.	✓	
• The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP.	✓	
• The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008.	✓	

Unaudited supplementary schedules

42. The supplementary information set out on pages xx to xx do not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion on them.

OTHER REPORTING RESPONSIBILITIES

REPORT ON PERFORMANCE INFORMATION

43. I have reviewed the performance information as set out on pages xx to xx.

Responsibility of the accounting officer for the performance information

44. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the

municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

45. I was engaged to review the performance information I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* [and section 45 of the MSA].
46. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
47. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings (performance information)

Non-compliance with regulatory requirements

48. The annual report of the Municipality did not include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the MSA, as required by section 121(3)(c) of the MFMA.
49. The Municipality did not appoint and budget for a performance audit committee, neither was another audit committee utilised as the performance audit committee.
50. The Municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal auditing processes as required in terms of section 45 of the MSA.

APPRECIATION

51. The assistance rendered by the staff of the Municipality during the audit is sincerely appreciated.

Auditor-General
Polokwane

28 November 2008



A U D I T O R - G E N E R A L